

1 KAREN A. OVERSTREET
Chief Bankruptcy Judge
2 United States Courthouse
700 Stewart St., Suite 6310
3 Seattle, WA 98101
206-370-5330
4

5 UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF WASHINGTON
6 AT SEATTLE

7 In re)
) Chapter 7
8 KENNETH ADAM BELL,)
)
9 Debtor.)
) Bankruptcy No. 09-13655
10)
11 _____)
BANNER BANK,) Adversary No. 09-01311
12)
13 Plaintiff.)
14 v.) **MEMORANDUM DECISION**
)
15 KENNETH ADAM BELL,)
) **NOT FOR PUBLICATION**
16)
17 Defendant.)
18 _____)

19 This matter came before me for trial on June 29, 2010. After
20 hearing the evidence and oral argument I took the matter under
21 advisement so that I could review more carefully the exhibits
22 admitted at trial. This Memorandum Decision contains my findings
23 of fact and conclusions of law for purposes of Bankruptcy Rule
24 7052. I have jurisdiction of this matter pursuant to 28 U.S.C.
25 §§ 157 and 1334 and this is a core proceeding under 28 U.S.C.
26 § 157(b)(2)(I) and (J).¹

27 ¹ Unless otherwise indicated, all Code, Chapter, Section and
28 Rule references are to the Bankruptcy Code, 11 U.S.C. §§101 *et seq.*
and to the Federal Rules of Bankruptcy Procedure, Rules 1001 *et*

1 For the following reasons, I find that the defendant, Kenneth
2 Bell, is entitled judgment and dismissal of all of plaintiff's
3 claims.

4 I. BACKGROUND

5 This is an action by plaintiff, Banner Bank ("Banner" or the
6 "Bank"), to except from discharge a debt alleged to be
7 approximately \$205,000 on the ground that it is nondischargeable
8 under Sections 523(a)(2)(B)(use of a fraudulent written statement),
9 523(a)(4)(defalcation while acting in a fiduciary capacity), and
10 523(a)(6)(malicious injury).

11 II. FINDINGS OF FACT²

12 A. Defendant's Businesses.

13 The defendant's corporations, Realty Executives,
14 Professionals, LLC ("Professionals") and RE Exec PNW, LLC ("PNW")
15 transacted business with Banner in 2001 and 2005, respectively.
16 Mr. Bell formed Professionals in 2001 as a real estate brokerage
17 with a single office and as a franchisee of Realty Executive
18 International ("REI"). In 2002, Professionals moved into a larger
19 office at 12207 8th Ave. N.E. in Bellevue, Washington ("8th Ave.").
20 Professionals opened a second office in 2004 located at 2370 130th
21 N.E. in Bellevue, Washington ("Bridal Trails"). Banner provided an
22 initial line of credit to Professionals for operating capital,
23 furniture and equipment, and other general purposes. Banner
24 provided additional financing to assist Professionals when it moved

25 _____
26 *seq.*

27
28 ² The admitted facts in the parties' pretrial order at Docket
No. 12 are incorporated herein by this reference.

1 to the 8th Ave. office and then in connection with its expansion to
2 the Bridal Trails office.

3 In 2004, Mr. Bell had an opportunity to purchase master
4 franchise agreement rights and to become a regional franchisor for
5 REI. Bell formed PNW to operate that franchise business. The Bank
6 provided PNW with part of the funds necessary to acquire the master
7 franchise rights under the Sub-Franchise Agreement with REI, which
8 was executed by Mr. Bell in December 2004. Ex. 16. Pursuant to
9 that agreement, PNW was required to pay an initial franchise fee of
10 \$193,550 in the form of a promissory note requiring a minimum
11 annual payment of accrued interest and payments of principal from
12 fees collected by PNW from its franchisees. By its terms, the note
13 was due and payable 10 years from the date of its execution.
14 Ex. 16. Pursuant to the terms of the Sub-Franchise Agreement, PNW
15 was authorized to use the REI name and real estate referral system
16 in both Washington and Oregon and to license franchisees in the
17 same states.

18 Both Professionals and PNW enjoyed financial success until
19 2007, when the real estate market began to collapse. In late 2007,
20 it became apparent that Professionals could not maintain two
21 offices so it closed the 8th Ave. office and consolidated its
22 business in the Bridal Trails office. Because Professionals was
23 still obligated on the lease at 8th Ave., it sought out a
24 sublessor, Brio Realty, Inc. ("Brio"), which took over the office
25 and the Professionals furniture and equipment located there.

26 Both Brio and Professionals continued to struggle financially
27 so in August of 2008, they decided to merge into a new entity, Brio
28 Professionals, LLC, dba Realty Executives Brio ("Brio LLC"). After

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1 the merger, Brio LLC moved its agents into the Bridal Trails office
2 and the 8th Ave. office was abandoned. Mr. Bell liquidated the
3 remaining office furniture and equipment at 8th Ave. through
4 Craigslist and obtained a few thousand dollars in proceeds.

5 On February 27, 2009, Banner filed a lawsuit against the
6 Mr. Bell in state court after the loans went into default.
7 Mr. Bell filed a chapter 7 bankruptcy proceeding on April 16, 2009.

8 **B. The Banner Bank Loans.**

9 The lending relationship between Banner and Professionals and
10 PNW extended from 2001 through 2008. The loans that are at issue
11 in this proceeding are described below.

12 On May 16, 2007, Professionals obtained a loan from Banner in
13 the principal amount of \$121,000 (Loan #2643). Ex. 1. This loan
14 was a renewal of an earlier loan. Exhibit 1, the promissory note
15 evidencing this loan states that the maturity date of the loan is
16 May 25, 2010. Also on May 16, 2007, Professionals obtained a
17 \$50,000 loan from Banner (Loan #0464). Ex. 2. This loan, which
18 was also a renewal of an earlier loan, had a maturity date of
19 May 10, 2008. Ex. 2.

20 On November 29, 2005, PNW obtained a loan from Banner in the
21 principal amount of \$46,131.72 (Loan #9103). Ex. 6. The
22 promissory note evidencing this loan states that the loan is
23 unsecured. Ex. 6, p. 2. The promissory note further states that
24 this loan would mature on December 10, 2008. On December 2, 2008,
25 PNW obtained a loan in the amount of \$39,614.43 (Loan #1791), which
26 was also a renewal of an earlier loan. Ex. 7. By the terms of the
27 note, it was to mature on November 15, 2009.

1 Loan #0464 was secured by a security interest in all accounts,
2 equipment, and general intangibles of Professionals. Ex. 4. It is
3 not clear whether Exhibit 4, a Commercial Security Agreement dated
4 August 7, 2001, also secures Loan #2643. Exhibit 4 states that it
5 secures a note dated August 7, 2001 in the principal amount of
6 \$35,000 and any renewals or extensions of that note. In any case,
7 when Loan #2643 was renewed on December 8, 2008, as described
8 below, Mr. Bell granted the Bank a lien against his personal
9 residence to secure this loan. Loan #1791 was secured by a
10 security interest in all inventory, chattel paper, accounts,
11 equipment and general intangibles of PNW. Ex. 9. Each of the
12 security agreements forbid the removal or sale of the collateral
13 without the Bank's consent.

14 Mr. Bell personally guaranteed payment and performance of the
15 obligations of Professionals to the Bank, Ex. 3, and the
16 obligations of PNW to the Bank, Ex. 8. Mr. Bell was the owner of
17 each of the entities and had access to, and control of, all of the
18 assets of these entities.

19 On December 2, 2008, PNW's Loan #9103 was renegotiated and
20 renewed in the reduced principal balance of \$5,388.97, and the
21 maturity date extended to March 10, 2009. Ex. 19. This loan
22 remained unsecured. Mr. Bell testified that the reduction in the
23 principal balance was due to the payments made since the execution
24 of the prior note in November of 2005. It does not appear that
25 PNW's Loan #1791 was ever renegotiated, probably because it was not
26 due to mature until November 15, 2009.

27 On December 8, 2008, Professionals executed a replacement
28 promissory note in favor the Bank for Loan #2643. The principal

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1 balance of the note was reduced to \$85,564.02, but the maturity
2 date was accelerated to May 15, 2009, from the maturity date of
3 May 25, 2010 in the May 2007 promissory note (Ex. 1). Ex. 21. The
4 promissory note recites that the Bank received additional
5 collateral for this loan in the form of a third deed of trust (the
6 "3rd DOT") against Mr. Bell's personal residence. Similarly, on
7 the same day, Professionals' Loan #0464 was renegotiated and
8 renewed in the principal amount of \$48,986.71, with a maturity date
9 of May 15, 2009, and with additional collateral pledged in the form
10 of the 3rd DOT. Ex. 20.

11 Mr. James Sleighter, the bank officer assigned to manage the
12 loans of Professionals and PNW, testified that he had a cordial and
13 cooperative relationship with Mr. Bell, that they frequently spoke
14 by telephone and met personally in the bank's branch about the
15 status of Mr. Bell's businesses and the loans. Mr. Bell's
16 testimony was consistent, and in addition, he testified that he
17 felt the Bank was always very supportive of his business efforts.

18 From the inception of the relationship, the Bank requested at
19 least annually copies of the companies' financial statements and
20 periodically also requested updated financial information each time
21 a new loan was made or an existing loan modified. Exhibit 10
22 contains a collection of financial information given to the Bank by
23 Mr. Bell and upon which the Bank relied, per the testimony of
24 Mr. Sleighter, in making and renewing the loans. The financial
25 statements in Exhibit 10 present consolidated balance sheet and
26 income information for both Professionals and PNW. The statements
27 do not break out the assets by office location. Mr. Sleighter
28 testified that he understood the financial statements he received

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1 from Mr. Bell showed assets on the balance sheet at their purchase
2 price reduced for depreciation, usually on an annual basis. He
3 also understood that accounts receivable shown on the balance sheet
4 represented desk fees payable by real estate agents working for the
5 companies or a franchisee of PNW, which fees would be payable only
6 if sales of real estate attributable to those agents actually
7 closed.

8 Mr. Bell testified that Mr. Sleighter was well aware of the
9 financial stresses of Mr. Bell's company in 2007 and 2008 when the
10 real estate market began to collapse. Mr. Sleighter testified that
11 the Bank was attempting to work with Mr. Bell during this difficult
12 period. He agreed that by 2007, it was no longer financially
13 feasible for Mr. Bell to maintain the 8th Ave. office and he
14 understood that the business would be moved from that location and
15 consolidated into the Bridal Trails office. Mr. Sleighter was
16 aware that Mr. Bell was attempting to sublease the 8th Ave. office
17 to cut down on the expense of that lease.

18 Mr Sleighter testified that in 2008 the Bank was attempting to
19 restructure Professionals' loans, which he testified were past due.
20 There is no evidence, however, of any notice of default on either
21 Loan #2643, which did not mature until May 25, 2010, or Loan #0464,
22 which would have matured on May 10, 2008. Both loans were
23 renegotiated in December 2008 as indicated above. The Bank,
24 concerned about its collateral coverage, asked for and received the
25 3rd DOT as additional collateral for these loans.

26 **III. CONCLUSIONS OF LAW**

27 Based upon the foregoing findings of fact, the Court makes the
28 following conclusions of law.

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1 The plaintiff has the burden of proving each element of
2 Section 523 by a preponderance of the evidence. *Grogan v. Garner*,
3 298 U.S. 279, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991). Exceptions to
4 discharge are to be construed strictly against the objecting
5 creditor and liberally in favor of debtor. *In re Linn*, 38 B.R. 762
6 (Bankr. 9th Cir. 1984).

7 **A. Section 523(a)(2) - Fraud.**

8 To prove fraud under Section 523(a)(2)(B), plaintiff must
9 prove the following elements: (1) use of statement in writing, (2)
10 that is materially false, (3) respecting the debtor's or an
11 insider's financial condition, (4) on which the creditor to whom
12 the debtor is liable for such money, property, services, or credit
13 reasonably relied; and (5) that the debtor caused to be made or
14 published with intent to deceive. Importantly, however, if the
15 creditor does not advance new money at the time of the
16 misrepresentation, but renews or extends the debt, it must
17 demonstrate that "it had valuable collection remedies at the time
18 of the extension or renewal, that it did not exercise in reliance
19 on the debtor's misrepresentation and that those remedies lost
20 value during the extension or renewal period...." in order to meet
21 the proximate cause element. *In re Kim*, 163 B.R. 157 (9th Cir. BAP
22 1994), *aff'd* 62 F.3d 1511 (9th Cir. 1995).

23 The substance of the Bank's claim is that in November of 2008,
24 when the loans were renegotiated and renewed, Mr. Bell presented
25 financial statements to the Bank which misrepresented that
26 Professionals had accounts receivables of \$68,050.22, a phone
27 system worth \$31,028.13, office equipment worth \$148,143.09, and
28 computer equipment of \$39,748.99. The Bank also relies on an email

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1 sent by Mr. Bell on October 23, 2008, in which he stated that the
2 "value in Master Franchise is Several Hundred Thousand more than I
3 owe" and that the value of Professionals was approximately \$10,000
4 per licensed agent, with the number of licensed agents being 87.
5 Ex. 12.

6 In late 2008, however, only three of the Bank's loans were
7 renegotiated, Loans #2643, #0464 and #9103. I find no evidence
8 that Loan #1791, Ex. 7, which was secured by the REI franchise
9 rights, was renewed or extended. That loan was not set to mature
10 until November 15, 2009, and there is no evidence that the Bank had
11 accelerated the loan on account of any default. Also, Loan 2643,
12 the largest loan owed by Professionals, and which was secured by
13 the furniture and equipment purchased for the Bridal Trails office,
14 was rewritten, but no new funds were advanced and rather than
15 extending the loan, the Bank moved up the maturity date on the loan
16 from May 2010 to May 2009. The Bank did not prove that it gave up
17 any valuable collection remedies at the time the loan was rewritten
18 and it in fact added collateral for the loan in the form of the 3rd
19 DOT. Loan #9103, which was extended in December 2008, was
20 unsecured and the Bank failed to demonstrate that it had any
21 valuable collection rights which it gave up at the time of the
22 extension. Thus, as to these loans, I conclude that the Bank has
23 failed to prove that any misrepresentation by Mr. Bell, assuming
24 there was one, was the proximate cause of its loss.

25 At the end of 2008, the maturity date of Loan #0464 was
26 extended from May 2008 to May 2009. In connection with the
27 renegotiation, the Bank also obtained the 3rd DOT to secure this
28 loan. There is no evidence, however, that had the Bank exercised

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1 its collection rights in late 2008 against collateral securing this
2 loan it would have avoided the loss it now claims. Mr. Sleighter
3 acknowledged that he knew that the personal property asset values
4 in the financial statements presented to him were based upon book
5 value rather than actual fair market value. In addition, the
6 balance sheets in Exhibit 10 show that the equipment had been
7 substantially depreciated. Mr. Bell testified that the most
8 valuable pieces of personal property are still in the Bridal Trails
9 office subject to the Bank's lien. Mr. Sleighter knew that the
10 accounts receivable were collectible only if the agents were able
11 to close sales of real property. The Bank provided no evidence of
12 what it could have collected had it exercised its remedies against
13 accounts receivable at the end of 2008. Finally, the Franchise
14 Agreement by its terms was not assignable without the consent of
15 the franchisor, REI, and it did not secure Loan #0464 in any case.
16 Because the Bank failed to prove that it lost valuable collection
17 rights by extending Loan #0464 for a one year period beyond its
18 maturity date, that loan cannot be the basis for a fraud claim
19 under Section 523(a)(2).

20 Thus, as to each of the loans, I conclude that the Bank has
21 failed to meet its burden on the proximate cause element of Section
22 523(a)(2).

23 **B. Section 523(a)(4)(Breach of Fiduciary Duty).**

24 To prove fraud or defalcation while acting in a fiduciary
25 capacity, a plaintiff must show that the defendant was a fiduciary
26 to whom funds were entrusted. The meaning of "fiduciary" under
27 Section 523(a)(4) is an issue of federal law. "Section 523(a)(4)
28 excludes constructive, resulting or implied trusts. A fiduciary

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1 relationship for purposes of § 523(a)(4) exists only where there is
2 an express or statutory trust. *In re Aubrey*, 111 B.R. 268, 275 (9th
3 Cir. BAP 1990); see also *In re Pedrazzini*, 644 F.2d 756, 758 n.
4 2(9th Cir. 1981)." *In re Martin*, 161 B.R. 672, 676 (9th Cir. BAP
5 1993). Courts must look to state law to determine whether the
6 requisite trust relationship exists. "The statute must define the
7 trust res, spell out the trustee's fiduciary duties and impose a
8 trust prior to and without reference to the wrong which created the
9 debt." *In re Baird*, 114 B.R. 198, 202 (9th Cir. BAP 1990).
10 Typically, the relationship between a guarantor and a creditor does
11 not create the requisite trust relationship. There was no evidence
12 presented of any special trust or fiduciary relationship between
13 the Mr. Bell and the Bank that would support relief under Section
14 523(a)(4).

15 **C. Section 523(a)(6)(Malicious Injury).**

16 Proof of a cause of action under Section 523(a)(6) requires a
17 two step process. First, plaintiff must prove that Mr. Bell
18 committed a "willful" injury. *Khaligh v. Hadaegh (In re Khaligh)*,
19 338 B.R. 817, 831 (9th Cir. BAP 2006). To satisfy the willfulness
20 element, a creditor must prove that the debtor deliberately or
21 intentionally injured the creditor, and that in doing so, the
22 debtor intended not just to commit the act itself, but also
23 intended the consequences of the act. See *Kawaauhau v. Geiger*, 523
24 U.S. 57, 61-62 (1998). Further, the Court must apply a subjective
25 test in determining the debtor's intent. "[Section] 523(a)(6)
26 renders a debt nondischargeable when there is either a subjective
27 intent to harm, or a subjective belief that harm is substantially
28

1 certain." *Carillo v. Su (In re Su)*, 290 F.3d 1140, 1144 (9th Cir.
2 2002).

3 The second step in the Section 523(a)(6) analysis is to
4 determine whether the debtor's conduct was "malicious." *Kaligh*,
5 338 B.R. at 831. In order to be found malicious, the debtor must
6 have committed a (1) wrongful act, (2) done intentionally,
7 (3) which necessarily causes injury, and (4) which is done without
8 just cause or excuse. *Id.* The last element, whether the act was
9 done without just cause or excuse, presents a mixed question of law
10 and fact. *Jett v. Sicroff (In re Sicroff)*, 401 F.3d 1101, 1105-06
11 (9th Cir. 2005), *cert. denied* 125 S.Ct. 2964 (2005). Evidence of
12 specific intent to injure can negate just cause or excuse.
13 *Khaligh*, 338 B.R. at 831.

14 Unlawful conversion of another's property may constitute a
15 willful and malicious injury. To prove conversion, the creditor
16 must prove that when the debtor converted the creditor's property,
17 he had the specific intent to deprive the creditor of the property
18 or did so knowing, with substantial certainty, that the creditor
19 would be harmed by the conversion. *Spokane Ry. Credit Union v.*
20 *Endicott (In re Endicott)*, 254 B.R. 471 (Bankr. D. Id. 2000). The
21 creditor is entitled only to damages in the amount of the value of
22 the property converted.

23 Plaintiff must prove some affirmative action by Mr. Bell
24 intended to injure plaintiff. For example, in the case of *In re*
25 *Foust*, 52 F.3d 766 (8th Cir. 1995), the court upheld the denial of
26 the debtor's discharge under Section 523(a)(6) where the debtor had
27 secretly converted crops which secured a government loan by selling
28 the crops to distant grain elevators and placing the proceeds of

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1 the sales in his personal accounts. The debtor then fabricated
2 reports of grain thefts to cover up his scheme. See also *Chrysler*
3 *Credit Corp. v. Perry Chrysler Plymouth, Inc.*, 783 F.2d 480 (5th
4 Cir. 1986)(discharge of corporate president denied under Section
5 523(a)(6) where he took proceeds of inventory sales to Las Vegas in
6 hope of winning enough money to save dealership).

7 No such malicious conduct has been proved in this case.

8 Mr. Bell testified that when Professionals abandoned and sublet its
9 8th Ave. office to Brio in 2007, it transferred what office
10 furniture and equipment it had left in that office to Brio for
11 \$2,000 and Brio's agreement to make Professionals' lease payments.
12 Mr. Bell testified that he discussed the arrangement with Mr.
13 Sleighter and advised him that the only alternative would be to put
14 the furniture and equipment in storage as it was not needed at the
15 Bridal Trails office and most of it was old and not worth much.
16 Mr. Sleighter disputed that he had discussed Mr. Bell's plan to
17 transfer the assets to Brio, but he admitted that he was aware that
18 Brio was going to take over the space and pay Professionals' lease
19 payments. When Brio vacated the 8th Ave. office in September 2008,
20 Mr. Bell listed and sold the remaining furniture and equipment at
21 that location on Craigslist for a total of \$4,191, which he then
22 used to invest in the new Brio LLC entity. See Ex. 13, 14, 15. At
23 the time Mr. Bell sold these assets, he testified that he believed
24 they were owned by Brio and not subject to the Bank's security
25 interest. He also testified that he believed the only way the Bank
26 could be repaid given the poor real estate market was if Brio and
27 his companies joined forces.

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1 Charles Johnson, attorney for Professionals, confirmed what
2 happened to the 8th Ave. office furniture and equipment in a letter
3 dated May 2009, to counsel for the Bank. Ex. 14. In that letter,
4 Mr. Johnson reiterated that all of the office furniture and
5 equipment financed by the Bank for the Bridal Trails office was
6 still in that office, had not been sold, and was being used by Brio
7 LLC.

8 The evidence shows that whatever furniture and equipment
9 remained at the 8th Ave. office was not of significant value.
10 Professionals, given its financial problems, could not continue to
11 maintain that office. Mr. Bell was trying to manage the problem of
12 finding a subtenant for the space and getting all of the furniture
13 and equipment out of the space when the landlord demanded removal
14 at the end of 2008. Mr. Sleighter was aware at that time that
15 Mr. Bell's companies were working with Brio LLC and that the 8th
16 Ave. office was being vacated. Yet, the Bank took no action to
17 even examine or inventory its collateral in that location. There
18 is no evidence of the kind of intentional, malicious conduct by
19 Mr. Bell in his actions that would warrant excepting from discharge
20 his liability to the Bank under Section 523(a)(6).

21 **D. Collateral Held by Brio LLC.**

22 There is no dispute that the most valuable furniture and
23 equipment assets of Professionals and PNW are currently in use in
24 the Bridal Trails office. Any merger between those entities and
25 Brio, to the extent there is a lawful merger, would not void the
26 lien of the Bank in those assets and there is nothing preventing
27 the Bank from seizing that collateral and liquidating it. In
28 addition, any interest of Mr. Bell in Brio LLC would be property of

1 the estate subject to liquidation by the trustee in the main case
2 for the benefit of creditors.

3 **CONCLUSION**

4 For the foregoing reasons, I will enter an order granting
5 judgment in favor the defendant, and dismissing all claims against
6 him, upon presentation by the defendant's counsel.

7
8 //End of Memorandum//

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11 
12 United States Bankruptcy Judge
13 (Dated as of Entered on Docket date above)
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